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SUBJECT: CZECH NATIONAL BANK PREDICTS SHALLOWER SLOWDOWN
AND FASTER INFLATION CORRECTION

REF: A. PRAGUE 258

[1](#)B. 07 PRAGUE 1201

[1](#)C. 07 PRAGUE 758

[1](#)1. SUMMARY: The Czech National Bank has revised its 2008 GDP growth forecast upward from 4.1% to 4.7% and confirmed its expectation that inflation will return to below 3% by 2009. At the same time, the CNB revised its 2009 GDP forecast downward from 4.6% to 4% based on lower export and investment projections. External assumptions behind CNB's forecast for the remainder of 2008 and 2009 include a slowdown in Eurozone growth, a spike in Eurozone inflation followed by a period of rapid decline, a gradual fall in Eurozone interest rates through 2008, higher oil prices, and continued appreciation of the Czech crown against the Euro. Market analysts agree that the Czech economy will continue on its path of strong growth with a shallower slowdown than previously expected, but there is healthy skepticism about the CNB's inflation prognosis. END SUMMARY.

[1](#)2. Econoff attended the Czech National Bank's (CNB) quarterly meeting with analysts on May 16. The session focused on the inflation outlook, given last quarter's (Q1/2008) record inflation that caught both the CNB and the market by surprise. January 2008 inflation data from the Czech Statistical Office revealed that CPI inflation hit 7.5% year-on-year -- the highest inflation rate since November 1998 and the fifth highest among EU member states. This figure was more than a full percentage point above market expectations and .8 pp above CNB forecast. The CNB reiterated that the inflation spike was "a temporary swing sparked by tax changes, increase in regulated prices (electricity, gas, housing services), and extraordinary high growth to food prices," and predicts inflation will ease back to 5.3% in Q4 2008 and 2.4% in Q2 2009. Having said that, the CNB acknowledged a pro-inflationary risk to its prognosis, noting that April 2008 headline inflation of 6.8% (released only days before the meeting so not included in the CNB' forecast model) is slightly above its new forecast.

[1](#)3. In April, the Czech Ministry of Finance (MinFin) also released its revised macroeconomic forecast for 2008 and [1](#)2009. Following a record growth of 6.6% in 2007, MinFin predicts GDP growth will slow to 4.9% in 2008 based on weaker foreign demand and somewhat weaker domestic consumption, then rise slightly to 5.1% in 2009. The most recent IMF forecast predicts 4.2% GDP growth for the Czech Republic in 2008, while CPI inflation is expected to decrease to 3.9% in 2008 and 2.9% in 2009. IMF projects unemployment levels to fall from 6.6% in 2007 to 5.2% in 2008 and to 4.3% in 2009.

[1](#)4. The CNB's optimism for accelerated decrease in inflation is based on a combination of restrictive fiscal policy, weak foreign demand, and continued strength of the Czech currency against the Euro and the Dollar. On fiscal policy, despite fears that the Czech Republic would significantly overshoot

its 3%/GDP budget deficit Maastricht criteria in 2007, revised data revealed a deficit of only 1.6%/GDP due to higher than expected GDP growth of 6.6%. Deficit forecast for 2008 is 1%/GDP compared to the 3%/GDP parameter approved in the 2008 budget bill, again due robust growth. 2009 budget forecast is slightly expansionary with fiscal deficit expected at 1.4%/GDP. One reason for skepticism about CNB's optimism for fast inflation correction is that while the CNB forecast assumes continued strengthening of the Czech crown, some market analysts predict the Czech crown will see an exchange rate correction by the end of 2008.

Grabner